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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

COMMENTS OF
SOUTHWESTERN BELL TELEPHONE COMPANY

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SUMMARY*

With this pleading, SWBT supports USTA's interstate proposal for preserving and advancing universal service, and provides its comments suggestions.

This universal service proceeding should be viewed as one of many interrelated dockets addressing the need to eliminate the implicit universal service support flows that now exists in LEC rates. As the Act makes clear, Congress now anticipates universal service support will be made explicit. To achieve that goal, incumbent LECs must be permitted to rebalance rates. In the interstate jurisdiction, it is imperative that CCL be eliminated by restructuring the charge in a four-year process that removes loop cost support for recovery through a deaveraged SLC, which would be capped at an Interstate Affordability Benchmark. LTS would also be removed from the CCL rates of non-pooling LECs. During the transition period, CCL and LTS would be bulk-billed until eliminated. Pay telephone support would be recovered though a per-call charge. Past experience has demonstrated that subscribership will not be harmed by increasing the SLC, and that consumers benefit from the resultant decrease in toll charges. To guard against any negative effect on low-income household subscribership, an expanded Lifeline with a nationwide eligibility standard would be implemented.

SWBT supports the definition of universal service proposed by the Commission, with some clarifications and the addition of single-party business service, a standard white page listing, and access to basic directory assistance. As that definition is changed in future proceedings, customer demand and marketplace acceptance should be the considerations. As to schools, libraries, and health care providers, care must be taken to avoid duplicating State efforts or double funding those efforts.

* The abbreviations used in this Summary are as defined in the main text.

SWBT also believes that the current practice of keeping prices for universal service artificially low should be ended, with an affordability benchmark adopted and used to determine when explicit funding should be made available and in what amounts. Lifeline and Link Up should be used to support those who cannot pay for the "affordable" service. However, the support for those two programs as well as TRS need to be made explicit.

SWBT believes that the Joint Board and the Commission should endorse and encourage use of the same definition of "universal service area" in the Federal and State. SWBT recommends that "universal service area" be defined to mean any geographic territory no smaller than the incumbent LEC's wire center and no larger than the incumbent LEC's geographic territory included in a basic local calling plan.

To calculate the amount of universal service support, SWBT believes that the actual costs of the eligible carrier must be used if the support is to be "specific" and "sufficient" as required by the Act. Accordingly, incumbent LECs should continue to use the Commission's existing fully distributed cost rules and other eligible providers should adopt the consistent cost calculation methods. The Benchmark Cost Model should not be adopted. SWBT has demonstrated that the BCM does a poor job of predicting the cost of providing service. SWBT also opposes the use of competitive bidding to set the level of universal service support. Using actual costs also ensures that the eligible carrier is using the support for its intended purpose, and that services not subject to competition are not subsidizing those that are.

Of all of the possible alternatives, SWBT believes that interstate retail telecommunications revenues should be adopted as the funding base for universal service. Unlike the others, using those revenues would not cause economic or pricing distortions. The necessary support should be generated by having all interstate carriers placing an explicit charge on its customer bills for interstate retail telecommunications services and paying the proceeds to a neutral third party administrator.

As broad as the scope of this proceeding is, the NPRM failed to address issues relating to the carrier of last resort obligations of incumbent LECs and eligible carriers generally, the enhanced service provider exemption which provides growing implicit support to thriving businesses, and capital recovery for under-depreciated past investment by incumbent LECs. Each are these arise from past regulatory and industry structures, are a part of the universal service debate, and must be resolved by the Joint Board and the Commission.

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COMMENTS OF
SOUTHWESTERN BELL TELEPHONE COMPANY

Southwestern Bell Telephone Company (SWBT) files these Comments in response to the Notice of Proposed Rulemaking and Order Establishing Joint Board (NPRM), released March 8, 1996, in this proceeding required by the Telecommunications Act of 1996 (Act). With this pleading, SWBT supports the interstate proposal being submitted in this proceeding by the United States Telephone Association (USTA) and provides additional comments and suggestions. USTA has constructed a proposal that meets the objectives established by the Act[1] to preserve and advance universal service at the interstate level, meets the needs of eligible schools, libraries, and rural health care providers, avoids interfering with competition, and permits the Commission to meet the Act's deadlines.

I. The Need for Rational Pricing

In various proceedings before the Commission, SWBT and its parent, SBC Communications Inc., have proposed and supported various actions that must be taken to ensure economically rational

[1] The USTA proposal is focused on the recovery of interstate universal service support amounts in response to the Act.

behavior among carriers and customers. From interstate access reform to LEC-CMRS interconnection,[2] Southwestern Bell has consistently sought the elimination of regulatory mandates that prevent market forces from providing the full benefits of competition to consumers. SWBT views this proceeding as one of many interrelated dockets that must be decided with an overall vision of permitting the industry to reach the objective of a "minute is a minute" pricing for carrier-to-carrier interconnection, and urges the Joint Board and the Commission to recognize that explicitly funding universal service is a piece (albeit major) of the larger issue of permitting rational pricing.

A major impediment to the "minute is a minute" interconnection objective has been the use of implicit support in local exchange carrier (LEC) rates to fund universal service. SWBT recently identified and quantified the implicit support embedded in its intraLATA toll and access rates (interstate and intrastate) at $1.5 billion a year.[3] The Act disavows that current practice, stating that "support should be explicit and sufficient." Section 254(e) (emphasis added). If these implicit

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[2] See USTA's Petition for Rulemaking, filed September 17, 1993; Comments of SBC Communications Inc. filed March 4, 1996, in *Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, Equal Access and Interconnection Obligations Pertaining to Commercial Radio Service Providers*, CC Docket No. 95-185.

[3] See *Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Comments of SWBT filed October 10, 1995 (SWBT 80-286 Comments), Appendix 8, "Analysis of Support Flows Implicit in Southwestern Bell's Rate Structure." These support flows include a total of $1.5 billion of annual interservice support primarily from intraLATA toll and access services. Interstate access services generate, primarily through carrier common line charges, approximately $355 million of this support. Attachment 1 summarizes the interstate and intrastate interservice support flows. $202 million of this interstate support is generated in high-volume, primarily urban areas, to help keep basic local exchange rates reasonable in low-volume, primarily rural areas.

support flows[4] are not eliminated, a principal goal of the Act will be frustrated, and the benefits of competition substantially diminished as LECs are kept at a significant pricing disadvantage.

Removing implicit support flows requires rebalancing rates. Such rebalancing would correct the interservice (e.g., from access and toll to local service) and intraservice (e.g., from low-cost to high-cost areas) implicit support transfers. Intraservice transfers can only be corrected by setting prices for smaller geographic areas that more closely match the market area for a service.[5] The prices for some services or for some geographic areas will increase while prices in low-cost areas or for low-cost services will decrease. Price rebalancing should be permitted on a revenue neutral basis. Where the rebalanced prices needed to recover the costs of providing universal service would be considered unaffordable, support will continue to be required. Costs which exceed an affordable level should be recovered through an explicit fund.

To the extent that rate restructuring is limited and does not allow for the recovery of existing implicit support, the amount of support required to be explicitly recovered will be larger. The greater the degree of rebalancing, the smaller the amount of explicit funding required. Movement toward efficient pricing further serves the public interest by eliminating uneconomic price umbrellas created

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[4] There are other implicit support flows, such as those in access transport prices, that should be addressed through rate restructuring. Additionally, there are intertemporal support flows resulting from under-depreciated investment (caused by not using economic depreciation rates) that must be addressed.

[5] Wholesale rates for resold local exchange service or its components should not be deaveraged unless and until the affected LECs are first allowed to deaverage retail local exchange service rates. No competitor should be allowed to purchase deaveraged resold or unbundled services or facilities to inefficiently undercut another carrier's mandated averaged retail rates. Such a policy could cause extensive financial losses to the incumbent LEC and uneconomic profits of the purchasing carrier, all without public benefit.

by current implicit universal service support rate structures. The Joint Board should recommend that LEC rates be restructured in both Federal and State jurisdictions to remove implicit support, and that pricing flexibility be permitted to allow more efficient market-driven solutions.

II. Necessary Changes to the CCL and Subscriber Line Charge

The Commission has concluded that "[t]he current CCL charge appears to be inconsistent with the directives of the 1996 Act . . ." NPRM, para. 113. SWBT agrees that recovering the interstate portion of universal service loop costs through interstate switched access charges is a form of implicit support and is inconsistent with the Act.[6] The interstate CCL should be eliminated[7] by replacing it with rebalancing of the subscriber line charges (SLCs), funding high-cost support on an explicit basis, and recovering interstate pay telephone costs through a per-call charge.[8]

SWBT concurs with USTA's proposal to modify the existing SLC caps to a level based on an Interstate Affordability Benchmark (as defined in USTA's proposal). The SLC and any support requirements could be calculated at a geographic level smaller than the current study area, consistent with economic principles and competition. If an area's interstate loop costs are less than the Interstate Affordability Benchmark, no support would be required and the SLC for customers in that

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[6] In that regard, see N.A.R.U.C. v. F.C.C., 737 F.2d 1095, 1134-36 (D.C. Cir. 1984), where the Court of Appeals affirmed the Commission's use of CCL as a transitional funding mechanism for universal service.

[7] A number of States require intrastate CCL rates to mirror interstate CCL levels. As interstate CCL rates are restructured, intrastate CCL rates and the portion of intraLATA toll rates that reflect loop recovery should also be restructured on a revenue-neutral basis in those States. Options include local rate changes and/or recovering the support from intrastate CCL and intraLATA toll on a flat-rate, bulk-billed basis from an intrastate support fund.

[8] As noted in the NPRM, pay telephone support is being addressed in a separate proceeding.

area could be reduced to that average cost level. Areas with interstate loop costs that exceed the Benchmark would receive funding for the difference from a new explicit interstate universal service funding mechanism. For those areas where the interstate loop costs are above the transitional SLC cap, CCL charges would continue through the four-year transition to recover the lesser of the difference between (1) the transitional SLC cap and the Interstate Affordability Benchmark; or (2) the transitional SLC cap and the area's interstate loop costs. The benchmark would always limit any end-user's SLC to an affordable level even if the actual loop cost is substantially higher. The four-year transition for SLC increases will minimize any potential adverse impacts.

Indeed, concerns over adverse effects on consumers have been refuted. Eliminating the interstate CCL and shifting recovery to end-users will lead to substantial economic gains for consumers as access price reductions generate toll reductions.[9] Economists have measured efficiency losses attributable to the toll-to-local subsidy in the billions of dollars.[10] The public record strongly supports this type of rate rebalancing.[11] The economic benefit that consumers would realize from

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[9] A. Larson, T. Makarewicz and C. Monson, "The Effect Of Subscriber Line Charges on Residential Telephone Bills," 13 *Telecommunications Policy* 337 (December 1989); also F. Wolak, "Can Universal Service Survive in a Competitive Telecommunications Environment?," (forthcoming in *Information Economics and Policy*), February 1996 Draft, pp. 5, 36. (Available from SWBT).

[10] Jerry Hausman *et al.* "The Effects of the Breakup of AT&T on Telephone Penetration in the U.S.," 83 *American Economic Review* 178 (1993) p. 183; also J. Griffin, "The Welfare Implications of Externalities and Price Elasticities for Telecommunications Pricing," 64 *Review of Economics and Statistics* 59-66 (Feb. 1982).

[11] See AT&T Comments in re: End User Common Line Charges, CC Docket 95-72, dated June 29, 1995, p. 12; In re: Rochester Telephone Corp. Petition for Waivers to Implement its Open Market Plan, Order in CC Docket 95-96, released March 7, 1995, p. 5; also Chairman Hundt's prepared address at the Competitive Telecommunications Association's (CompTel) Fall

interstate access rebalancing that includes full recovery of interstate loop costs through the SLC will be over $7 billion annually.[12]

Increasing the SLC in the manner proposed will not harm subscribership. Past increases in the SLC did not harm subscribership; telephone subscribership increased from 91.6 percent when the SLC was implemented in 1984, to 93.1 percent when the SLCs were capped in 1989.[13] Econometric estimates indicate such rate rebalancing if accompanied by toll decreases will not cause subscribers to disconnect. Studies show that toll usage costs are responsible for customers dropping off the network, not monthly charges.[14] Rate rebalancing could well improve subscribership.[15] Moreover, phasing in SLC increases over four years, as USTA proposes, will allow subscribers to adjust to those gradual rate changes.

Expanding Lifeline with its focus on low-income subscribers would also help avoid any potential decrease in subscribership. Lifeline (as well as Link Up) will be vital to those households

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Business Conference, Oct. 10, 1995, New Orleans, LA, p. 3; and Hundt's prepared address at the National Consumers Week Symposium, Oct. 26, 1995, Washington, DC, p. 3.

[12] T. Makarewicz, "Efficient Telecom Pricing: Who Stands to Benefit?," *Public Utilities Fortnightly*, March 15, 1996, pp. 26-32 (included as Attachment 2). Makarewicz estimates that a uniform SLC of $5.85, plus a $0.25 switching port charge, would result in an estimated net gain in consumer surplus nationwide ranges from $7 to $7.5 billion annually.

[13] A. Belinfante, "Telephone Subscribership in the United States," released December 1995, Table 2.

[14] Affordability of Telephone Service: A Survey of Customers and Non-Customers," Field Research Corporation, funded by GTE and Pacific Bell, at p. 5, filed in CC Docket No. 80-286, ex parte dated April 26, 1995, by Pacific Bell.

[15] Hausman, *et al*, *supra* note 2 at 182, also Wolak, *supra* note 4 at 4-5.

that cannot pay the affordable price for universal service, as well as to ease the transition to market-based pricing. SWBT thus supports an expanded Lifeline program, and recommends that some of the benefits gained from reducing CCL (and the resulting interstate toll rates) be devoted to that goal. SWBT proposes expanding the program by (1) waiving the entire SLC for qualified Lifeline participants, and (2) establishing a uniform national standard for Lifeline SLC waiver eligibility so that participants whose annual incomes fall below the Federal poverty level (e.g., $12,600 for a family of four) would qualify. SWBT estimates that expanding Lifeline in this way could add from $400-500 million annually to the nationwide Lifeline cost.

However, in keeping with the intent of the Act, both Lifeline and Link Up as well as Telecommunications Relay Service (TRS) should be explicitly funded.[16] The existing funding structure for the intrastate portion of Lifeline and TRS are clearly implicit and thus conflicts with the preference for explicit funding in the Act.[17] SWBT recommends the contributions to these beneficial programs be explicitly identified and funded through a competitively neutral mechanism.

In sum, combining rate rebalancing with a Lifeline expansion would create a more efficient pricing structure that would eliminate major sources of indiscriminate implicit support, enhance

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[16] NPRM, para. 61. Whether Link Up is removed from the separations process is of little importance so long as explicit funding is assured.

[17] Not only does this structure result in implicit support for Lifeline, but more importantly it constitutes a *disincentive* to promoting and advancing Lifeline service. Under such implicit funding, the more successful a LEC's Lifeline programs, the more cost must be recovered by that LEC's intrastate rates.

consumer welfare, and protect, if not augment, subscribership levels.[18]

III. What Is "Universal Service"?

SWBT supports the definition of universal service proposed by the Commission as eligible for support and augments it as follows: (1) voice grade access to the public switched network, with the ability to place and receive calls; (2) touch-tone; (3) single-party residential and business local service;[19] (4) access to emergency services (911/E911) where provided by local authorities; and (5) access to basic operator services. In addition, the following should also be included within that definition: (6) a standard white page directory listing; and (7) access to basic local directory assistance. Each of the services set forth meet the criteria of Section 254(c), and each can be provided in a technologically and competitively neutral manner. However, a transition period may be required to permit any upgrades necessary to satisfy the Federal universal service definition (e.g., multiparty to single-party service).

The Act also establishes that universal service will evolve, and that the Commission will need to review the initial definition "taking into account advances in telecommunications and information technologies and services." Section 254(c)(1). The cost of deploying advanced services should not be underestimated, however. Prior to expanding the definition beyond those set forth above, consideration must be given to which services "have, through the operation of market choices by

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[18] P. Cain & J. MacDonald, "Telephone Pricing Structures: The Effects on Universal Service," 3 *Journal of Regulatory Economics* 293, 303 (1991).

[19] The results of a SWBT study demonstrates support is necessary for some SWBT business customers, located primarily in rural service areas. A comparison of local exchange costs for basic exchange services to business customers in rural low-volume areas shows that approximately 53% of these costs are currently recovered from implicit support mechanisms.

customers, been subscribed to by a substantial majority of residential customers." Section 254(c)(1)(B). Customer demand, marketplace acceptance and deployment costs should be the key considerations to determining whether and when to expand the definition of universal service.

IV. Schools, Libraries, and Health Care Providers

The Commission and the Joint Board should recognize that a significant number of important regulatory initiatives that benefit schools, libraries, and health care providers have already been implemented or are already underway in the States. Attachment 3 describes the initiatives in the States of Arkansas, Kansas, Missouri, Oklahoma, and Texas. Any Federal support to those selected end-users must complement and not overlap or duplicate State initiatives. That support should be explicit and separately identified from high-cost or low-income support.

V. Affordable Service

In addition to the longstanding duty to ensure"just and reasonable" rates, the Act expressly directs the Commission and the States to ensure that the services constituting universal service also be "affordable." Prices for basic local service provided by incumbent LECs usually have been set by pricing such service residually and without regard to cost, thus ensuring "affordability" through implicit means. Artificially low prices for basic local service have been extended to all consumers regardless of whether the service area was high cost or low cost and regardless of consumer ability to pay the cost incurred in providing the local service.

Holding universal service prices artificially low across broad geographic areas violates the pro-competitive and deregulatory goals of the Act, as well as increases the amount of the needed explicit funding. The Act requires reliance upon competition to help ensure prices, including those for universal service, remain affordable. For consumers to benefit from competition, market-based pricing and pricing flexibility for all services by all providers must be allowed. Explicit funding should be made available only for those areas where the cost of providing universal service is so high that competition cannot ensure prices for universal service are "affordable."

A measure of affordability must therefore be determined and used. "Affordability" refers to the customer's ability to pay the cost of universal service. From a customer's perspective, the price of universal service must consider the total charge for universal service. Due to the multi-jurisdictional nature of universal service, the total charge is comprised of both Federal and State prices.

The customer's ability to pay the cost of universal service should be determined by treating the total charge (both interstate and intrastate) as a household expenditure that is expressed as a percentage of median household income. By viewing the total universal service charge in such a manner, policy makers will have a basis for comparison with other types of household expenditures. The Joint Board should thus identify a percentage of median household income that constitutes an affordable amount to pay for universal service. This means of identifying affordability will ensure consistency and comparability in that it is reasonable to expect customers on average to spend an equivalent amount of their total household expenditures on universal service.

In identifying that percentage, the Joint Board should compare the percentages of household income made on other expenditures. Consumers currently spend slightly more than 4% of their income on residential energy consumption.[20] Over 3% of median income is spent on gasoline and motor oil, while approximately 1.5% is spent on housekeeping supplies.[21] The purchase of alcoholic beverages consume 1% of median income. In contrast, the current expenditure level for basic local exchange service is approximately 0.7% of median household income, with overall expenditures for telecommunications is 2-2.5% of median household income.[22]

In light of those percentages, SWBT supports an average spending level for universal service of 1% of median household income as a reasonable benchmark. Attachment 4 provides a summary of illustrative benchmarks for the five States in which SWBT operates. Although this would reflect an increase in the amount paid for universal service (from 0.7% to 1%), overall customer spending on telecommunications should not increase from the current level if prices for other telecommunications services decrease as a result of replacing implicit support with price rebalancing and explicit funding. Raising the affordability level and the accompanying rate rebalancing to reflect a higher affordability benchmark would also lower the amount of explicit high-cost support required to fund universal service.

The affordability benchmark would provide a point of reference, above which the relevant costs to provide universal service would be considered high cost and eligible for recovery through

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[20] U.S. Energy Information Administration, "Household Energy Consumption and Expenditures, 1990."

[21] U.S. Bureau of Labor Statistics, Consumer Expenditures in 1991 - BLS Report 835, December 1992.

[22] Federal Communications Commission, "Trends in Telecommunications, Table 8, May 1994 at p. 13.

explicit support funding. Correspondingly, eligible carriers would need the flexibility to price the services comprising the universal service definition subject to the constraint that they do not exceed an affordability benchmark; otherwise, the explicit support would not be "sufficient" under Section 254(b)(5). The benchmark would also serve as a reference point for rate rebalancing efforts, such that the rates for universal service in areas receiving high-cost support would not exceed an affordable level.

VI. What Is A "Universal Service Area"?

"Universal service areas" for purposes of universal service must be established to determine the area over which high costs are to be judged. To encourage uniformity of funding between the States, SWBT believes that the Joint Board and the Commission should endorse and encourage the States to adopt the same "universal service area" definition.

Calculating universal service support levels using state-wide average cost and rate data maintains the current system of uneconomic pricing and implicit support and fails to provide an incentive for competitive entry in high-cost rural areas while maintaining the current artificial attractiveness of urban population centers as competitive targets. Calculating a single level of universal service support for a broad geographic area, such as an entire state, would result in support levels being too high in urban areas, and too low in rural regions. Different levels of universal service high-cost support for various geographic markets would more closely align the economic incentives with cost characteristics in each market, thereby encouraging efficient entry while avoiding subsidizing the entry of inefficient firms. Accordingly, SWBT recommends that large LECs' "universal service areas" be defined to mean any geographic territory no smaller than the incumbent

LEC's wire center and no larger than the incumbent LEC's geographic territory included in a basic local calling plan.

VII. Universal Service Costs

For support to be "specific" and "sufficient" under Section 254(b)(5), it must be based upon the costs incurred by the service provider and must represent the difference between the historical cost of providing universal service and the actual revenues collected for such service. In determining explicit support levels, all eligible providers should use consistent methods for the calculation of costs and revenues.

The method employed in the USTA plan calculates the support based on costs identified by Parts 36 and 69 of the Commission rules. The use of fully distributed cost principles should continue to be used by incumbent LECs and should be adopted by other eligible carriers. Any concern that carriers not subject to Parts 36 and 69 would be disadvantaged by this approach can be addressed by allowing those carriers to use some simplified form of those cost allocation rules, with an upper limit on their support levels defined as the level of support for the incumbent LEC in a specific geographic area.[23] The development of a support structure is more likely to be concluded within the Act's narrow time constraints by making minor, simplifying modifications to the existing cost allocation principles in Part 36 and relying on the support levels of the incumbent LEC as a backstop. There would be no need for a protracted delay while new cost proxy methods and alternatives to cost allocation are developed, evaluated, and debated.

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[23] Based on the fact that competition benefits consumers through lower rates for services provided at lower costs, SWBT believes that if an incumbent carrier receives no high-cost support in an area, then no other eligible carrier should receive high-cost support in that area.

Additionally, costs need not be adapted or updated until the definition of universal service changes. Each carrier's cost should be used to develop a universal service support amount per line that would be frozen until the definition changes. All carriers -- both incumbent LECs and other eligible carriers -- will be on a common footing for explicit identification of subsidy qualification. This will help to ensure that one competitor is not advantaged over another. So long as the use of cost allocations is limited to establishing equitable support mechanisms and not setting prices, this limited use of regulatory cost methods would be consistent with Congressional intent to provide a pro-competitive and deregulatory framework.

A. Use of Benchmark Costing

SWBT has analyzed the Benchmark Costing Model (BCM) and is convinced that it does not provide a reasonable comparison to actual costs by study area (company) or by wire center. The Joint Sponsors have admitted that "[t]he BCM does not define the actual cost of any telephone company, nor the embedded costs that a company might experience in providing telephone service today."[24] However, before any model can be adopted, the validity of that model must be established by testing its hypothesis against known and measurable results. The only appropriate test is the comparison to actual network costs of study areas across the nation.

SWBT has compared the BCM for each State and each incumbent LEC (1,511 study areas, of which 795 are "Cost" study areas, 616 are "Average Schedule" study areas, and an additional 100 study areas created by the BCM due to its mapping process) to actual Universal Service Fund (USF)

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[24] MCI Communications Inc., NYNEX Corporation, Sprint/United Management Co., and U S WEST, Inc., Benchmark Cost Model: A Joint Submission, Copyright 1995, CC Docket No. 80-286 (Dec. 1, 1995), at I-2, Item 3.

information as reported to the National Exchange Carriers Association (NECA) for each of the following items:

- BCM investment per household to USF investment per loop
- BCM loop costs per household to the USF loop costs per loop
- BCM loop investment by wire center to SWBT actual embedded costs by wire center.
- BCM calculated count of households and square miles for each LEC to its actual data as reported to the Commission in response to the USF data request.[25]

The results of SWBT's analysis show that:

(1) The BCM calculated loop investment per household is at least 50% different than actual company results for 34% of the LECs (see Attachment 5, p. 4).

(2) The BCM ARMIS-based annual cost calculation is at least 50% different than actual data for 40% of the LEC study areas. (Attachment 5, p. 8)

(3) The BCM Hatfield-based annual cost calculation is at least 50% different than actual data for 29% of the LEC study areas. (Attachment 5, p. 8)

(4) The BCM investment per household was different by at least 25% for **85%** of SWBT's 506 wire centers in Texas. (Attachment 5, p. 17)

The BCM significantly misstates the size of areas associated with a LEC's operations and the numbers of customers (or households) in a LEC's service areas. These problems with the BCM are caused by difficulty of and inaccuracies in the mapping of Census data to carrier operating boundaries.[26]

In contrast to the simulated costs advocated in the BCM, actual cost data has been reported

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[25] Order in Docket 80-286, released December 1, 1994.

[26] See SWBT ex parte, CC Docket No. 80-286, filed February 19, 1996 (revision of February 14, 1996, ex parte).

under uniform procedures by LECs and audited by the Commission and State commissions for many years. Substituting a cost proxy for reliable factual data, much less a cost proxy as demonstrably inaccurate as the BCM, is unwarranted and unreasonable. Use of the BCM will deny eligible carriers, both incumbent LECs and new entrants, recovery of the actual historical costs of providing universal service. The areas identified as high cost by the BCM are not always high cost and some actual high cost areas are missed entirely by the BCM. Thus, the BCM merely identifies areas assumed to have the highest costs, not areas where the highest costs actually are. Adopting a demonstrably inaccurate proxy model to address the assumed unwillingness of new entrants to offer consistent, uniform, accurate, and actual data comparable to that supplied by an incumbent LEC is simply wrong. To be competitively neutral in its treatment of incumbents and new entrants, the Commission should not adopt an inaccurate, unreliable, and unrepresentative benchmark cost model,[27] but rather should require all eligible carriers to use a simplified version of the Commission's cost allocation rules.

B. Use of Competitive Bidding

SWBT has previously set forth its concerns to a bidding process for high-cost universal service funding.[28] The Act did not modify the basis for those objections. SWBT still does not believe that competitive bidding is necessary, appropriate, or warranted for high-cost support determination. Given the lack of any demonstrable need today or in the foreseeable future, the resources necessary to properly structure a competitive bidding process (a possibility which SWBT strongly doubts) are

[27] SWBT is not familiar with the Pacific Telesis proxy model currently being considered for California intrastate purposes and cannot comment on that proxy model at this time.

[28] SWBT 80-286 Comments at p. 15.

best spent elsewhere.[29]

VIII. Explicit Support Mechanisms

Explicit interstate support mechanisms will be needed in some areas to maintain reasonable local exchange rates for basic access to the public network. The primary focus should be to maintain a consistent, predictable level of interstate support. State commissions have taken into account interstate support in setting current rates for local exchange service. Interstate support for basic local exchange rates and universal service funding should be explicitly funded.

SWBT concurs with USTA that a new explicit interstate high-cost funding mechanism should be used to fund:

- interstate loop costs that exceed the Interstate Affordability Benchmark;
- existing USF and Dial Equipment Minutes (DEM) weighting support for rural incumbent LECs;[30]
- existing USF and DEM weighting for non-rural incumbent LECs[31] frozen and eliminated at the end of the four-year transition period.

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[29] Before any consideration can be given to adopting any bidding procedure, it must be determined whether the "losing" bidders/carriers in a bidding process would retain any carrier-of-last-resort obligation (including any readiness to serve obligation), or whether any such obligation automatically ceases. Otherwise, a competitor will be able to impose a level of support that is below-cost for the incumbent carrier-of-last-resort. Regardless, the potential for gaming the process to the detriment of competition and competitors is obvious. To hold an incumbent carrier to carrier-of-last-resort obligations but refuse to allow it to recover its costs would be confiscatory and otherwise unlawful.

[30] As the record in CC Docket 80-286 demonstrated, it is essential that USF and DEM weighting be maintained in essentially their current forms to fund the high costs of small incumbent LECs that serve rural areas. See, e.g., SWBT Reply Comments filed November 9, 1995, in CC Docket No. 80-286.

[31] "Non-rural" incumbent LECs are all current LECs not identified as rural by the Act.

USTA's proposal recommends that CCL and LTS be maintained during the transition period. CCL and LTS will decrease as SLC prices are increased. During the transition, CCL and LTS should be bulk billed instead of recovered through usage-sensitive switched access rates of non-pooling LECs. At the end of the transition period, CCL and LTS would be eliminated.

IX. Use of Explicit Support

Support can only be directed to an "eligible carrier" pursuant to Section 214(e), which is expressly left to the States to certify.[32] The Commission therefore has no role in the certification process. However, the Commission can assure that support is being used for its intended purpose, and any services that are not competitive are not subsidizing services that are subject to competition by using actual costs.

X. How and on What Should Contributions Be Assessed

SWBT supports the USTA proposal that the support contribution be based on interstate retail telecommunication service revenues rather than on the other alternatives proposed in the NPRM. Retail revenues are those collected by carriers for services sold as final products to end-user consumers and do not include "wholesale" revenues collected from services sold as intermediate inputs to the services to other carriers. Using interstate retail telecommunication revenues as the funding basis provides a reasonably simple and economically efficient method for collecting the funds and satisfies the Act and its legislative intent. The intent of making support explicit is to remove implicit support from the services sold as input to other carriers. Thus, excluding these services from

[32] As part of the certification process, the States should continue to fulfill their historical role of requiring compliance with uniform quality and service standards for universal service (e.g., installation, repair). See Sections 254(b)(1) (principle of quality service); 254(f).

the revenue base is correct.

In contrast, the methods proposed in the NPRM may cause economic distortions; basing contributions on gross revenues, or on gross revenues net of payments made to other carriers, places a "tax" on input or wholesale services which creates uneconomic incentives to avoid those input or wholesale services. For example, requiring a carrier to make contributions based on access service revenues (an input or wholesale service) will cause the effective cost of access to be higher, which may induce purchasers of access to seek ways to avoid purchasing access services. If the funding is instead based on retail revenues, that uneconomic incentive is eliminated and funding is properly targeted. Moreover, methods that base contributions on per-line or per-minute units depend on the manner in which services are sold, and would create market distortions that can be avoided by using retail revenues as the base.

With regard to whether to include intrastate revenues in the allocation base for the Federal universal service funds, SWBT believes that the base for its proposed interstate fund should only include interstate retail telecommunications revenues. The methods by which carriers already determine interstate revenues for TRS purposes could easily be modified to estimate interstate retail telecommunications revenues.

The easiest method to make support funding explicit is to establish a surcharge that is to be assessed by carriers to their interstate retail telecommunications service customers. This surcharge would be an explicit charge stated on a customer's bill and would be a set percentage of the interstate amount billed. The surcharge level would depend on the level of interstate retail telecommunications revenues and the total support needed, and must be equivalent for all interstate carriers to satisfy the equitable and nondiscriminatory requirements. Proceeds from that surcharge would then be remitted to a neutral third-party administrator.[33]

XI. Who Should Fund

The Commission must ensure that "[a]ll providers of telecommunications services make an equitable and nondiscriminatory contribution." Section 254(b)(4). Accordingly, all interstate carriers -- including incumbent LECs, other LECs, resellers, wireless carriers, interexchange carriers, competitive access carriers, and alternate operator service providers -- that provide interstate retail telecommunications services to end-users should be included within that base.

XII. The Unaddressed Issues

There are a few issues not raised in the NPRM that must be addressed if the deregulatory and pro-competitive goals of the Act are to be achieved. These issues are so fundamental that they cannot be addressed later or in a vacuum, but must be part of the comprehensive universal service structure fashioned under the Act.

A. Carrier of Last Resort Obligations

Historically, the carrier of last resort obligation (including readiness to serve) has been inextricably linked to universal service. Achieving the concept of universal service has historically consisted of (i) deploying and maintaining a universally available telecommunications network capable of providing two-way switched voice service (ii) that customers may access at reasonable rates. The

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[33] SWBT recommends that the Joint Board consider NECA for the role of administrator. NECA's prior cost-efficient administration of other funds and its already high level of knowledge and skill in these areas argue for giving NECA serious consideration among the possible candidates for administrator.